Citizens Bancshares Corporation

Florence

Camden

Hartsville

McBee

2018 Annual Report

TO OUR SHAREHOLDERS AND FRIENDS:

We are pleased to present this annual report of the financial condition of Citizens Bancshares Corporation, and its wholly owned subsidiary, The Citizens Bank (collectively, the "Company").

For our Company, 2018 was a memorable year and I would like to share with you some of the more interesting developments.

On November 30, 2018, we completed our acquisition of Regional Bankshares, Inc., and its subsidiary Heritage Community Bank (collectively, “Heritage”). As part of that transaction, Heritage was merged into our Company adding three new branches to the offices of The Citizens Bank in Hartsville, Camden and McBee, South Carolina. The merger also increased our Company's net loans by approximately $83 million and its total deposits by approximately $94 million. We are pleased with our success of fully integrating the business of Heritage into The Citizens Bank, largely as the result of the extraordinary efforts of the staffs of both banks.

In connection with the merger of Heritage into our Company, we issued approximately 225,227 shares of Citizens Bancshares common stock to about 511 former shareholders of Regional Bankshares. We welcome them to our corporate family. Also, in connection with the merger, we have selected Direct Transfer LLC, to act as the Company's stock transfer agent. Transfers of the company's stock will now be handled through our transfer agent.

In order to make it easier to buy and sell shares of the company’s stock, we applied for and received a ticker symbol. Our new ticker symbol is CITZ, and we are now traded on the Pink® Open Market through the OTC MarketPlace. Additionally, we are pleased to have a registered broker-dealer that has begun to act as a market maker for the company’s Common stock. Our goal is to give our shareholders the ability to buy and sell our shares through a broker of their choice.

Net income in 2018 was $4,249,000, the highest in the history of the company, as compared to $3,732,000 a year earlier. Basic earnings per share in 2018, were $2.41 compared to $2.11 one year earlier. Our increase in net income was attributable to an improvement in net interest income and a lower Federal corporate income tax rate attributable to the Tax Cuts and Jobs Act of 2017.

Total assets of the Company closed the year at $537,258,000, compared to $432,771,000 at year- end 2017. Total deposits were $468,744,000 at year-end, as compared to $371,565,000 one year earlier. Loans net of unearned income and the allowance for loan losses totaled $368,637,000 at year- end 2018, as compared to $268,439,000 at year- end 2017. Shareholders' equity increased to $55,165,000 at year- end 2018, as compared to $45,115,000 at year- end 2017. Per share book value was $28.01 at year-end, compared to $25.86 one year earlier. Our loan loss reserve totaled $3,317,000, or 0.90% of total loans and is deemed appropriate.

Nonperforming loans to gross loans at year-end were 0.57%, as compared to our national peer group of 0.56%. Net loan charge-offs to average total loans were 0.08%, as compared to our national peer group of 0.08%. During 2018, we relocated our Palmetto Street Office in Florence from a modular building to a permanent location a few blocks away at 1600 W. Palmetto Street. This beautiful, renovated building houses our full- service branch as well as corporate office space. Operationally, during the year we replaced the bank’s personal computers at all locations in anticipation of future technology changes.

We are off to a great start through the first quarter of 2019. Our budget for 2019 projects another record earnings year based on the additional loans and deposits as provided by the merger with Heritage. We have several operational improvements planned for 2019, including upgrading our ATM's, our deposit accounts platform, and our teller system. Our employees performed admirably during the year and we commend them for their efforts in making 2018 a success. Our employees remain our greatest assets and we express our sincere appreciation for their service to our organization.

I retired from my position as President of The Citizens Bank effective January 01, 2019. Tommy Bouchette has replaced me as President and Chief Operating Officer, and I am now Vice-Chairman of the Board of The Citizens Bank. Tommy has been with The Citizens Bank since 2015, and has 32 years of experience as a banker, including 5 years as the organizer, President/CEO, and Board member of a community bank in Murrells Inlet, SC.
Serving as President of our bank has been a great honor for me, particularly because of the quality and dedication of the team it has been my privilege to lead. Our success in providing state of the art banking services to the communities we serve has been very satisfying as is the knowledge that the leadership of The Citizens Bank will remain in good hands.

Our commitment is to continue to maximize shareholder value by growing our company in a safe and sound manner. We are grateful to our directors, employees and customers for continued success. Your support is greatly appreciated and, as always, we welcome your comments and suggestions.

Sincerely,

H. Blake Gibbons, Jr.
Vice Chairman

Citizens Bancshares Corporation

Report on Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

Citizens Bancshares Corporation
Contents

Independent Auditor's Report

The Board of Directors
Citizens Bancshares Corporation
Olanta, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Citizens Bancshares Corporation and its subsidiary which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to the consolidated financial statements (collectively, "financial statements").

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Citizens Bancshares Corporation and its subsidiary as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Columbia, South Carolina
April 9, 2019

Citizens Bancshares Corporation

Consolidated Balance Sheets

As of December 31, 2018 and 2017

(Dollars in thousands)	2018	2017
Assets:		
Cash and cash equivalents:		
Cash and due from banks	$ 24,581	$ 15,646
Federal funds sold	-	942
Interest-bearing deposits	29,612	51,132
Total cash and cash equivalents	54,193	67,720
Other interest-bearing balances	4,242	4,983
Investment securities:		
Securities available-for-sale	69,911	65,473
Nonmarketable equity securities	1,179	1,024
Total investment securities	71,090	66,497
Loans receivable	371,954	271,877
Less allowance for loan losses	(3,317)	(3,438)
Loans, net	368,637	268,439
Premises, furniture and equipment, net	16,572	12,729
Bank owned life insurance	7,327	4,322
Cash surrender value of life insurance	1,631	1,528
Goodwill	6,736	3,427
Core deposit intangible	2,049	34
Accrued interest receivable	2,016	1,535
Other real estate owned	523	197
Deferred tax asset	1,363	847
Other assets	879	513
Total assets	$ 537,258	$ 432,771
Liabilities:		
Deposits:		
Noninterest-bearing transaction accounts	$ 132,114	$ 98,031
Interest-bearing transaction accounts	97,017	84,830
Savings	126,714	97,717
Certificates of deposit $250,000 and over	15,296	7,708
Other time deposits	97,603	83,279
Total deposits	468,744	371,565
Advances from the Federal Home Loan Bank	9,000	15,000
Junior subordinated debenture	2,899	-
Accrued interest payable	322	127
Other liabilities	1,128	964
Total liabilities	482,093	387,656
Commitments and contingencies (Notes 11, 19 and 21)		
Shareholders' equity:		
Common stock, $1.00 par value; 2,500,000 shares authorized; 2,387,675 and 2,162,448 shares issued and outstanding at December 31, 2018 and 2017, respectively	2,388	2,163
Capital surplus	7,993	1,461
Retained earnings	54,578	50,852
Treasury stock, at cost (417,809 shares at December 31, 2018 and 2017, respectively)	(8,063)	(8,063)
Accumulated other comprehensive loss	(1,731)	(1,298)
Total shareholders' equity	55,165	45,115
Total liabilities and shareholders' equity	$ 537,258	$ 432,771

See Notes to Consolidated Financial Statements

Citizens Bancshares Corporation

Consolidated Statements of Income

For the years ended December 31, 2018 and 2017

(Dollars in thousands, except per share amounts)	**2018**	**2017**
Interest income:		
Loans, including fees	$ 15,422	$ 14,048
Investment securities:		
Taxable	1,036	1,011
Tax-exempt	409	444
Nonmarketable equity securities	54	26
Federal funds sold	89	61
Deposits with other banks	1,007	638
Total interest income	18,017	16,228
Interest expense:		
Deposits	1,106	762
Advances from the Federal Home Loan Bank	267	218
Total interest expense	1,373	980
Net interest income	16,644	15,248
Provision (recovery) for loan losses	100	(750)
Net interest income after provision (recovery) for loan losses	16,544	15,998
Noninterest income:		
Service charges on deposit accounts	2,161	1,948
Residential mortgage origination fees	252	290
Loss on sale of securities	-	(9)
Income from cash surrender value of life insurance	111	112
Brokerage fees	440	419
Credit card and interchange fees	1,315	1,188
Other operating income	615	682
Total noninterest income	4,894	4,689
Noninterest expense:		
Salaries and employee benefits	8,663	8,164
Net occupancy	1,420	1,291
Furniture and equipment	998	872
FDIC assessments	139	153
Communications	148	147
Net cost of other real estate owned	72	82
Other operating	4,385	3,675
Total noninterest expense	15,825	14,384
Income before income taxes	5,613	6,303
Income tax expense related to ordinary operations	1,364	2,093
Income tax expense related to change in tax rate	-	478
Total income tax expense	1,364	2,571
Net income	$ 4,249	$ 3,732
Earnings per share		
Basic	$ 2.41	$ 2.11
Diluted	$ 2.31	$ 2.02

See Notes to Consolidated Financial Statements

Citizens Bancshares Corporation

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2018 and 2017

(Dollars in thousands)	**2018**	**2017**
Net income	$ 4,249	$ 3,732
Other comprehensive (loss) income		
Unrealized holding (losses) gains arising during the period	(621)	852
Tax effect	188	(273)
Reclassification of losses realized during the period	-	13
Tax effect	-	(4)
Reclassification of accumulated other comprehensive loss due to tax rate change	-	(214)
Other comprehensive (loss) income, net of tax	(433)	374
Comprehensive income	$ 3,816	$ 4,106

See Notes to Consolidated Financial Statements

Citizens Bancshares Corporation

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31, 2018 and 2017

(Dollars in thousands, except shares)	Common stock Shares	Common stock Amount	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2016	2,162,448	$ 2,163	$ 1,461	$ 47,413	$ (6,686)	$ (1,672)	$ 42,679
Net income	-	-	-	3,732	-	-	3,732
Other comprehensive Income, net of taxes	-	-	-	-	-	588	588
Purchase of treasury stock	-	-	-	-	(1,377)	-	(1,377)
Reclassification of other comprehensive loss due to tax rate change	-	-	-	214	-	(214)	-
Cash dividends paid ($0.29 per share)	-	-	-	(507)	-	-	(507)
Balance, December 31, 2017	2,162,448	2,163	1,461	50,852	(8,063)	(1,298)	45,115
Net income	-	-	-	4,249	-	-	4,249
Other comprehensive loss, net of taxes	-	-	-	-	-	(433)	(433)
Issuance of common stock	225,227	225	6,532	-	-	-	6,757
Cash dividends paid ($0.30 per share)	-	-	-	(523)	-	-	(523)
Balance, December 31, 2018	2,387,675	$ 2,388	$ 7,993	$ 54,578	$ (8,063)	$ (1,731)	$ 55,165

See Notes to Consolidated Financial Statements

Citizens Bancshares Corporation
Consolidated Statements of Cash Flows
For the years ended December 31, 2018 and 2017

(Dollars in thousands)	2018	2017
Operating activities:		
Net income	$ 4,249	$ 3,732
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (recovery) for loan losses	100	(750)
Depreciation	676	679
Amortization of intangible assets	34	126
Writedown of other real estate owned	26	49
Gain on sales and disposals of other real estate owned, net	(2)	(6)
Loss on sale of securities available-for-sale	-	9
Discount accretion and premium amortization, net	161	187
Net funding and sale activity in residential mortgages held-for-sale	-	644
Increase in interest receivable	(481)	(33)
Increase in interest payable	195	9
Increase in BOLI and cash surrender value of life insurance	(213)	(265)
Decrease in other assets	232	498
(Decrease) increase in other liabilities	(53)	312
Net cash provided by operating activities	4,924	5,202
Cash flows from investing activities:		
Purchases of securities available-for-sale	(1,506)	(2,000)
Net purchase of nonmarketable equity securities	(155)	(326)
Net increase in loans made to customers	(20,835)	(15,877)
Purchases of other interest-bearing balances	1,741	1,740
Purchases of premises and equipment, net	(1,000)	(326)
Proceeds from disposal of premises and equipment	872	-
Proceeds from sales of other real estate owned	167	409
Proceeds from sales of securities available-for-sale	-	580
Proceeds from calls, maturities and paydowns of securities available-for-sale	1,220	3,475
Net cash received in business combination	8,709	-
Net cash used in investing activities	(10,787)	(12,325)
Cash flows from financing activities:		
Net increase in demand deposits, interest-bearing transaction accounts and savings accounts	1,585	1,554
Net increase (decrease) in certificates of deposit and other time deposits	4,024	(9,103)
Cash dividends paid	(523)	(507)
Purchase of treasury stock	-	(1,377)
(Repayment of) proceeds from Federal Home Loan Bank advances	(12,750)	8,000
Net cash used in financing activities	(7,664)	(1,433)
Net (decrease) increase in cash and cash equivalents	(13,527)	(8,556)
Cash and cash equivalents, beginning of year	67,720	76,276
Cash and cash equivalents, end of year	$ 54,193	$ 67,720
Non cash investing and financing activities		
Unrealized (loss) gain on securities available-for-sale, net of tax	$ (433)	$ 579
Transfer of loans to other real estate owned	$ 367	$ 31
Cash paid during the year for:		
Interest	$ 1,179	$ 970
Income taxes	$ 1,479	$ 1,794

See Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation:

The accompanying consolidated financial statements include the accounts of Citizens Bancshares Corporation, a bank holding company (the Company) and its wholly-owned subsidiary, The Citizens Bank (the Bank). The principal business activity of the Bank is to provide banking services to domestic markets in the Midlands, Pee Dee, and Coastal areas of South Carolina. The consolidated financial statements include the accounts of the parent and its wholly-owned subsidiary after elimination of all significant intercompany balances and transactions.

Management's Estimates:

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and income and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, including valuation allowances for impaired loans, impairment calculation of goodwill, fair value of investments and the carrying amount of real estate acquired in connection with foreclosures or in satisfaction of loans. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change materially in the near term.

Significant Group Concentrations of Credit Risk:

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in the Pee Dee and Coastal regions of South Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions except for loans secured by commercial and residential real estate and commercial and industrial non-real estate loans.

Note 1. Summary of Significant Accounting Policies

Significant Group Concentrations of Credit Risk, continued:

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g., principal deferral periods, loans with initial interest-only periods, etc.) and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e., balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

The Company's investment portfolio consists primarily of obligations of the United States, its agencies or its corporations and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Investment Securities:

All debt securities have been designated as available-for-sale by the Company and are carried at amortized cost and adjusted to their estimated fair value. The unrealized gain or loss is recorded in shareholders' equity net of the deferred tax effects. Management does not actively trade securities classified as available-for-sale but intends to hold these securities for an indefinite period of time and may sell them prior to maturity to achieve certain objectives. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis in the security. The adjusted cost basis of securities available-for-sale is determined by specific identification and is used in computing the realized gain or loss from a sales transaction.

Nonmarketable Equity Securities:

Nonmarketable equity securities include the Company's investment in the stock of the Federal Home Loan Bank. These securities are carried at cost because they have no quoted market value and no ready market exists. Investment in Federal Home Loan Bank stock is a condition of borrowing from the Federal Home Loan Bank, and the stock is pledged to collateralize any borrowings. At December 31, 2018 and 2017, the investment in Federal Home Loan Bank stock was $1,122,000 and $1,024,300, respectively. The Company also had an investment in Community Banker's Bank stock of $57,420 as of December 31, 2018. The Company had no investment in Community Banker's Bank stock as of December 31, 2017. Dividends received on nonmarketable equity securities are included as a separate component in interest income.

Note 1. Summary of Significant Accounting Policies, Continued

Loans Receivable:

Loans receivable are stated at their unpaid principal balance, net of any charge-offs. Interest income on loans is computed using the simple interest method and is recorded in the period earned. When serious doubt exists as to the collectability of a loan or a loan is contractually 90 days past due, the accrual of interest income is generally discontinued unless the estimated net realizable value of the collateral is sufficient to assure collection of the principal balance and accrued interest. When interest accruals are discontinued, interest accrued but uncollected is reversed. Loans are removed from nonaccrual status when they become current as to both principal and interest, when concern no longer exists as to the collectability of the principal and interest, and after a sufficient history of satisfactory payment performance has been established.

The Company identifies impaired loans through its normal internal loan review process. Loans on the Company's problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether the borrower will be able to perform in accordance with the loan agreement. Loans are not considered impaired if a minimal payment delay occurs and all amounts due, including accrued interest at the contractual interest rate for the period of delay, are expected to be collected.

Acquired Loans:

Purchased credit-impaired loans ("PCI") are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB Accounting Standards Codification Topic 310-30, "*Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality,"* formerly American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 03-3, "*Accounting for Certain Loans or Debt Securities Acquired in a Transfer*," and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be PCI loans. Evidence of credit quality deterioration as of purchase dates may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. The Company considers expected prepayments and estimates the amount and timing of expected principal, interest and other cash flows for each loan or pool of loans meeting the criteria above, and determines the excess of the loan's scheduled contractual principal and contractual interest payments over all cash flows expected to be collected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the loan's or pool's cash flows expected to be collected over the fair value for the loan or pool of loans, is accreted into interest income over the remaining life of the loan or pool (accretable difference). Subsequent to the acquisition date, increases in cash flows expected to be received in excess of the Company's initial estimates are reclassified from nonaccretable difference to accretable difference and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses.

Acquired non-impaired loans are recorded at their initial fair value and adjusted for subsequent advances, pay downs, amortization or accretion of any premium or discount on purchase, charge-offs and additional provisioning that may be required.

Note 1. Summary of Significant Accounting Policies, Continued

Allowance for Loan Losses:

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows or collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

When the ultimate collectability of an impaired loan's principal is in doubt, wholly or partially, cash receipts are applied to principal. Once the reported principal balance has been reduced to the loan's estimated net realized value, future cash receipts are applied to interest income, to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged-off. When this doubt does not exist, cash receipts are applied under the contractual terms of the loan agreement first to interest income then to principal.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring. For these accruing impaired loans, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting.

Note 1. Summary of Significant Accounting Policies, Continued

Premises, Furniture and Equipment:

Premises, furniture and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed principally by accelerated cost recovery methods allowed for income tax reporting purposes if there are no material differences from generally accepted accounting principles. Rates of depreciation are generally based on the following estimated useful lives: buildings and land improvements - 10 to 40 years and furniture and equipment - 5 to 10 years. The cost of assets sold or otherwise disposed of and the related accumulated depreciation is eliminated from the accounts, and the resulting gains or losses are reflected in the income statement. Maintenance and repairs are charged to current expense as incurred, and the costs of major renewals and improvements are capitalized.

Other Real Estate Owned:

Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is initially recorded at the lower of the loan amount or fair value less estimated costs to sell. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value less costs to sell. Costs to maintain such assets, subsequent write-downs, and gains and losses on disposal are charged to expense and are included in net cost of other real estate owned.

Goodwill and Other Intangible Assets:

Goodwill represents the cost in excess of fair value of net assets acquired (including identifiable intangibles) in purchase transactions. Other intangible assets represent premiums paid for acquisitions of core deposits (core deposit intangibles). Core deposit intangibles are being amortized over a 10 year period based on amortization schedules prepared by an outside consultant. Goodwill and identifiable intangible assets are reviewed for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of identifiable intangible assets is measured by a comparison of the carrying amount of the asset to future undiscounted cash flows expected to be generated by the asset. The Company's evaluation considers various components, to include economic conditions, industry considerations, financial performance as well as other information. No impairment losses have been recorded as a result of the Company's analysis during the years ended December 31, 2018 and 2017.

Retirement and Deferred Compensation Plans:

The Bank has a profit sharing plan covering all full-time employees with at least twelve months of service and who have obtained the age of eighteen. Normal retirement age is the first of the month following attainment of age sixty-five or ten years of participation if later. Early retirement can be obtained at age fifty-five upon ten years of participation. Expenses charged to earnings for the years ended December 31, 2018 and 2017 totaled $375,000 and $350,000, respectively, and are included within salaries and employee benefits.

Income and Expense Recognition:

The accrual method of accounting is used for all significant categories of income and expense. Immaterial amounts of insurance commissions and other miscellaneous fees are reported when received.

Note 1. Summary of Significant Accounting Policies, Continued

Residential Mortgage Origination Fees:

The Company's residential mortgage lending activities for sale in the secondary market are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgage loans and selling mortgage loans to investors under pre-existing commitments. Funded residential mortgages held temporarily for sale to investors are recorded at the lower of cost or market value. Application and origination fees collected by the Company are recognized as income upon sale to the investor.

Income Taxes:

Amounts provided for income taxes are based on income reported for financial statement purposes. Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded.

Business Combinations:

The Company accounts for business combinations using the acquisition method of accounting. The accounts of an acquired entity are included as of the date of acquisition, and any excess of purchase price over the fair value of the net assets acquired is capitalized as goodwill. Under this method, all identifiable assets acquired, including purchased loans, and liabilities assumed are recorded at fair value. The Company typically issues common stock and/or pays cash for an acquisition, depending on the terms of the acquisition agreement. The value of shares of common stock issued is determined based on the market price of the stock as of the closing of the acquisition.

Advertising Expense:

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising and public relations costs of $326,863 and $343,338, were included in other operating expenses for 2018 and 2017, respectively.

Note 1. Summary of Significant Accounting Policies, Continued

Comprehensive Income:

The Company reports comprehensive income in accordance with Accounting Standards Codification (ASC) 220, "Comprehensive Income." ASC 220 requires that all items that are required to be reported under accounting standards as comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The disclosure requirements have been included in the Company's consolidated statements of comprehensive income. The only item included in accumulated other comprehensive (loss) income on the balance sheets is unrealized holding gains and losses on available-for-sale investment securities.

Per-Share Amounts:

Basic earnings per-share is computed by dividing net income by the weighted-average number of shares outstanding for the period. Diluted earnings per-share is similar to the computation of basic earnings per-share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. The dilutive effect of options outstanding under the Company's stock option plan are reflected in diluted earnings per-share by the application of the treasury stock method. See Note 13.

For purposes of computing earnings per-share, allocated shares and shares released for allocation by the employee retirement and stock ownership plan, The Citizens Bank KSOP Plan (the KSOP), a component of which includes Company stock, are considered outstanding.

Statement of Cash Flows:

For purposes of reporting cash flows in the financial statements, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, interest-bearing deposits, and federal funds sold. Generally, federal funds are sold for one day periods.

Off-Balance-Sheet Financial Instruments:

In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

Note 1. Summary of Significant Accounting Policies and Activities, Continued

Recently Issued Accounting Pronouncements:

The following is a summary of recent authoritative pronouncements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Company will apply the guidance using a modified retrospective approach. The Company's revenue is comprised of interest income and noninterest income. The scope of the guidance explicitly excludes interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of the Company's revenues will not be affected. The Company is currently assessing revenue contracts related to revenue streams that are within the scope of the standard. The Company's accounting policies will not change materially since the principles of revenue recognition from the ASU are largely consistent with existing guidance and current practices applied by our business. The Company has not identified material changes to the timing or amount of revenue recognition. Based on the updated guidance, the Company does anticipate changes in disclosures associated with our revenues. The Company will provide qualitative disclosures of performance obligations related to our revenue recognition and will continue to evaluate disaggregation for significant categories of revenue in the scope of the guidance.

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. The Company expects to adopt the guidance using the modified retrospective method and practical expedients for transition. The practical expedients allow us to largely account for our existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. The Company has started an initial evaluation of our leasing contracts and activities. The Company has also started developing our methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments. The Company does not expect a material change to the timing of expense recognition, but is early in the implementation process and will continue to evaluate the impact. The Company is evaluating our existing disclosures and may need to provide additional information as a result of adoption of the ASU.

Note 1. Summary of Significant Accounting Policies and Activities, Continued

Recently Issued Accounting Pronouncements, continued:

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for annual periods beginning after December 15, 2020, and interim periods within annual reporting periods beginning after December 15, 2021. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company will apply the amendments to the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in first quarter 2019, the Company does not expect to elect that option. The Company is evaluating the impact of the ASU on our consolidated financial statements. The Company expects the ASU will have no material impact on the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. In addition to our allowance for loan losses, the Company will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In January 2017, the FASB amended the Goodwill and Other Topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2017, the FASB amended the requirements in the Receivables - Nonrefundable Fees and Other Costs Topic of the Accounting Standards Codification related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments will be effective for the Company for annual periods beginning after December 15, 2019, and interim periods within annual reporting periods beginning after December 15, 2020. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In February 2018, the FASB amended the Income Statement - Reporting Comprehensive Income Topic of the Accounting Standards Codification. The amendments allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company adopted this pronouncement by retrospective application to each period (or periods) in which the effect of the change in the tax rate was recognized. The impact of the reclassification from other comprehensive income to retained earnings was $214,000.

Note 1. Summary of Significant Accounting Policies and Activities, Continued

Recently Issued Accounting Pronouncements, continued:

In February 2018, the FASB amended the Financial Instruments Topic of the Accounting Standards Codification. The amendments clarify certain aspects of the guidance issued in ASU 2016-01. The amendments are effective for the same dates as those described in ASU 2016-01. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted ASU 2016-01. The Company does not expect these amendments to have a material effect on its financial statements.

In November 2018, the FASB issued guidance to amend the Financial Instruments - Credit Losses topic of the Accounting Standards Codification. The guidance aligns the implementation date of the topic for annual financial statements of nonpublic companies with the implementation date for their interim financial statements. The guidance also clarifies that receivables arising from operating leases are not within the scope of the topic, but rather, should be accounted for in accordance with the leases topic. The amendments will be effective for the Company for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently in the process of evaluating the impact of adoption of this guidance on the financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Risks and Uncertainties:

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Reclassifications:

Certain captions and amounts in the 2017 consolidated financial statements were reclassified to conform with the 2018 presentation. These reclassifications had no effect on the results of operations or shareholders' equity.

Note 2. Mergers and Acquisitions

On November 30, 2018, the Company acquired the outstanding common stock of Regional Bankshares, Inc. ("Heritage"), the bank holding company for Heritage Community Bank. In connection with the acquisition, the Company acquired $109.4 million of assets and assumed $101.4 million of liabilities.

The total purchase price was $11.3 million based on 751,176 shares of Heritage common stock, agreed to be purchased at $15 per share. The purchase price was paid in exchange for a combination of the Company's common stock and cash equal to a 60/40 ratio, resulting in $4.5 million in cash and the issuance of 225,227 shares of the Company's common stock valued at $6.8 million. Heritage shareholders received one share of the Company's common stock in exchange for two shares of Heritage common stock.

The Heritage transaction was accounted for using the acquisition method of accounting, and accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair value on the acquisition date based on a third party valuation of significant accounts. Fair values are subject to refinement for up to a year.

The following table presents the assets acquired and liabilities assumed as of November 30, 2018, as recorded by the Company on the acquisition date and initial fair value adjustments:

	As Recorded by Heritage	Fair Value Adjustments	As Recorded by the Company
Assets			
Cash and cash equivalents	$ 13,216	$ -	$ 13,216
Investment securities	5,934	-	5,934
Loans	82,444	(2,613)	79,831
Allowance for Loan Losses	(282)	282	-
Premises and equipment	4,091	335	4,426
Core Deposit Intangible	-	2,049	2,049
Other Real Estate Owned	150	-	150
Other assets	3,786	-	3,786
Total assets	$ 109,339	$ 53	$ 109,392
Liabilities			
Deposits	$ 91,631	$ (63)	$ 91,568
Advances from Federal Home Loan Bank	6,750	-	6,750
Junior subordinated debenture	3,093	(194)	2,899
Other Liabilities	261	(45)	216
Total liabilities	101,735	(302)	101,433
Net assets acquired over liabilities assumed			$ 7,959
Consideration:			
Value of stock issued		$ 6,757	
Cash exchanged for stock and fractional shares		4,511	
Total Fair Value of consideration transferred			$ 11,268
Goodwill			$ 3,309

Note 2. Mergers and Acquisitions, Continued

The merger included the acquisition of $82.4 million in gross loans and $91.6 million in deposits. The loan portfolio was purchased at a $2.6 million discount that will be accreted over the remaining maturity of the loans purchased. The deposits were purchased for a premium, including a $2 million core deposit intangible. The amortization of the core deposit intangible is based on the cash flows used to value the asset over a ten year life.

The fair value of consideration paid exceeded the fair value of the identifiable assets and liabilities acquired and resulted in the establishment of goodwill in the amount of $3.3 million, representing the intangible value of Heritage's business within the markets it served.

Note 3. Restrictions on Cash and Due From Banks

The Company is required by regulation to maintain an average cash reserve balance based on a percentage of deposits. At December 31, 2018 and 2017, the required cash reserve was satisfied by vault cash and cash held at other financial institutions.

Note 4. Investment Securities

Securities available-for-sale consisted of the following:

	December 31, 2018			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government-sponsored enterprises	$ 43,327	$ -	$ (1,750)	$ 41,577
Obligations of state and local governments	18,990	13	(465)	18,538
U.S. Treasuries	9,935	4	(143)	9,796
	$ 72,252	$ 17	$ (2,358)	$ 69,911

	December 31, 2017			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government-sponsored enterprises	$ 43,326	$ -	$ (1,343)	$ 41,983
Obligations of state and local governments	19,895	59	(331)	19,623
U.S. Treasuries	3,972	-	(105)	3,867
	$ 67,193	$ 59	$ (1,779)	$ 65,473

Note 4. Investment Securities, Continued

The following is a summary of maturities of securities available-for-sale as of December 31, 2018. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	Securities Available-For-Sale	
(Dollars in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 7,986	$ 7,970
Due after one year but within five years	26,490	25,738
Due after five years but within ten years	32,830	31,439
Due after ten years	4,946	4,764
Total	$ 72,252	$ 69,911

At December 31, 2018 and 2017, investment securities with a book value of $23,741,093 and $19,850,000 and a market value of $23,027,025 and $19,249,853, respectively, were pledged as collateral to secure public deposits and for other purposes as required or permitted by law.

During 2017 proceeds from sale of securities available-for-sale totaled approximately $580,000, with losses on sales of approximately $9,000. During 2018, no securities classified as available-for-sale were sold.

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2018 and 2017.

Securities Available-for-Sale

	December 31, 2018					
	Less than twelve months		Twelve months or more		Total	
(Dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Government-sponsored enterprises	$ -	$ -	$ 41,577	$ 1,750	$ 41,577	$ 1,750
Obligations of state and local governments	2,240	32	12,363	433	14,603	465
U.S. Treasuries	5,473	7	3,341	136	8,814	143
	$ 7,713	$ 39	$ 57,281	$ 2,319	$ 64,994	$ 2,358

Note 4. Investment Securities, Continued

	December 31, 2017					
	Less than twelve months		Twelve months or more		Total	
(Dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Government-sponsored enterprises	$ 7,125	$ (119)	$ 34,858	$ (1,224)	$ 41,983	$ (1,343)
Obligations of state and local governments	2,623	(24)	9,150	(307)	11,773	(331)
U.S. Treasuries	975	(10)	2,892	(95)	3,867	(105)
	$ 10,723	$ (153)	$ 46,900	$ (1,626)	$ 57,623	$ (1,779)

Securities classified as available-for-sale are recorded at fair market value. Of the securities in an unrealized loss position at December 31, 2018, one hundred and fourteen individual securities were in a continuous loss position for twelve months or more. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of its amortized cost.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

Note 5. Loans Receivable

Loans receivable consisted of the following at December 31, 2018 and 2017:

(Dollars in thousands)	2018	2017
Real estate - construction	$ 28,314	$ 22,083
Real estate - commercial	112,740	73,653
Real estate - residential	158,428	116,813
Commercial and industrial	48,646	36,936
Consumer and other	23,826	22,392
Total gross loans	371,954	271,877
Less allowance for loan losses	(3,317)	(3,438)
Loans, net	$ 368,637	$ 268,439

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2018:

(Dollars in thousands)	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Commercial and Industrial	Consumer and Other	Total
Allowance for loan losses:						
Beginning balance	$ 206	$ 1,355	$ 773	$ 698	$ 406	$ 3,438
Charge-offs	(84)	(1)	(30)	(93)	(92)	(300)
Recoveries	3	-	18	24	34	79
Provisions	147	(576)	696	(4)	(163)	100
Ending balance	$ 272	$ 778	$ 1,457	$ 625	$ 185	$ 3,317
Ending balances:						
Individually evaluated for impairment	$ -	$ -	$ 192	$ 64	$ -	$ 256
Collectively evaluated for impairment	$ 272	$ 778	$ 1,265	$ 561	$ 185	$ 3,061
Loans receivable:						
Ending balance - total	$ 28,314	$ 112,740	$ 158,428	$ 48,646	$ 23,826	$ 371,954
Ending balances:						
Individually evaluated for impairment	$ 36	$ 1,039	$ 1,590	$ 201	$ 35	$ 2,901
Collectively evaluated for impairment	$ 28,278	$ 111,701	$ 156,838	$ 48,445	$ 23,791	$ 369,053

Note 5. Loans Receivable, Continued

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2017:

(Dollars in thousands)	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Commercial and Industrial	Consumer and Other	Total
Allowance for loan losses:						
Beginning balance	$ 344	$ 1,531	$ 1,104	$ 749	$ 528	$ 4,256
Charge-offs	(76)	-	-	(31)	(133)	(240)
Recoveries	1	-	9	92	70	172
Provisions	(63)	(176)	(340)	(112)	(59)	(750)
Ending balance	$ 206	$ 1,355	$ 773	$ 698	$ 406	$ 3,438
Ending balances:						
Individually evaluated for impairment	$ 79	$ 3	$ 40	$ 1	$ 1	$ 124
Collectively evaluated for impairment	$ 127	$ 1,352	$ 733	$ 697	$ 405	$ 3,314
Loans receivable:						
Ending balance - total	$ 22,083	$ 73,653	$ 116,813	$ 36,936	$ 22,392	$ 271,877
Ending balances:						
Individually evaluated for impairment	$ 212	$ 398	$ 971	$ 171	$ 72	$ 1,824
Collectively evaluated for impairment	$ 21,871	$ 73,255	$ 115,842	$ 36,765	$ 22,320	$ 270,053

Credit Quality Indicators

The Company uses a risk based approach based on the following credit quality measures when analyzing the loan portfolio: pass, watch, special mention, and substandard. These indicators are used to rate the credit quality of loans for the purposes of determining the Company's allowance for loan losses.

Grades 1, 2, and 3 are considered "Acceptable/Pass", and are deemed to be loans that are performing and are deemed adequately protected by the net worth of the borrower or the underlying collateral value. These loans are considered the least risky in terms of determining the allowance for loan losses.

Grades 4 is considered "Watch - Special Mention", respectively, and are deemed to be loans that have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's position at some future date.

Grade 5 is considered "Substandard", and is deemed to be loans that are considered the most risky. These loans typically have an identified weakness or weaknesses and are inadequately protected by the net worth of the borrower or collateral value.

Note 5. Loans Receivable, Continued

The following table lists the loan grades used by the Company as credit quality indicators and the balance in each category.

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2018:

(Dollars in thousands)	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Commercial and Industrial	Consumer and Other	Total Loans Receivable
Grade 1	$ -	$ -	$ -	$ 1,902	$ 867	$ 2,769
Grade 2	-	-	-	-	-	-
Grade 3	27,992	107,949	152,813	46,099	22,832	357,685
Grade 4	112	2,809	1,651	256	69	4,897
Grade 5	210	1,982	3,964	389	58	6,603
	$ 28,314	$ 112,740	$ 158,428	$ 48,646	$ 23,826	$ 371,954

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2017:

(Dollars in thousands)	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Commercial and Industrial	Consumer and Other	Total Loans Receivable
Grade 1	$ -	$ -	$ -	$ 2,826	$ 1,226	$ 4,052
Grade 2	-	-	-	-	-	-
Grade 3	21,359	70,742	113,059	33,291	20,905	259,356
Grade 4	420	2,042	2,205	464	148	5,279
Grade 5	304	869	1,549	355	113	3,190
	$ 22,083	$ 73,653	$ 116,813	$ 36,936	$ 22,392	$ 271,877

The following is an aging analysis of our loan portfolio at December 31, 2018:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment >90 Days and Accruing
Real estate - construction	$ 22	$ -	$ -	$ 22	$ 28,292	$ 28,314	$ -
Real estate - commercial	821	197	358	1,376	111,364	112,740	31
Real estate - residential	1,222	191	1,517	2,930	155,498	158,428	314
Commercial and industrial	112	58	134	304	48,342	48,646	11
Consumer and other	184	16	25	225	23,601	23,826	9
	$ 2,361	$ 462	$ 2,034	$ 4,857	$ 367,097	$ 371,954	$ 365

The following is an aging analysis of our loan portfolio at December 31, 2017:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment >90 Days and Accruing
Real estate - construction	$ 35	$ -	$ 168	$ 203	$ 21,880	$ 22,083	$ -
Real estate - commercial	12	2	341	355	73,298	73,653	74
Real estate - residential	411	172	365	948	115,865	116,813	8
Commercial and industrial	43	96	32	171	36,765	36,936	13
Consumer and other	97	26	27	150	22,242	22,392	-
	$ 598	$ 296	$ 933	$ 1,827	$ 270,050	$ 271,877	$ 95

Note 5. Loans Receivable, Continued

The following is an analysis of our impaired loan portfolio detailing the related allowance recorded at December 31, 2018:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Real estate - construction	$ 36	$ 36	$ -	$ 40	$ -
Real estate - commercial	1,039	1,052	-	1,046	19
Real estate - residential	988	988	-	1,004	22
Commercial and industrial	112	112	-	137	5
Consumer and other	35	35	-	39	2
	2,210	2,223	-	2,266	48
With an allowance recorded:					
Real estate - construction	$ -	$ -	$ -	$ -	$ -
Real estate - commercial	-	-	-	-	-
Real estate - residential	602	602	192	603	12
Commercial and industrial	89	89	64	97	5
Consumer and other	-	-	-	-	-
	691	691	256	700	17
Total:					
Real estate - construction	$ 36	$ 36	$ -	$ 40	$ -
Real estate - commercial	1,039	1,052	-	1,046	19
Real estate - residential	1,590	1,590	192	1,607	34
Commercial and industrial	201	201	64	234	10
Consumer and other	35	35	-	39	2
	$ 2,901	$ 2,914	$ 256	$ 2,966	$ 65

The following is an analysis of our impaired loan portfolio detailing the related allowance recorded at December 31, 2017:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Real estate - construction	$ 76	$ 76	$ -	$ 79	$ 1
Real estate - commercial	329	329	-	335	5
Real estate - residential	636	636	-	654	9
Commercial and industrial	118	118	-	128	3
Consumer and other	36	36	-	42	2
	1,195	1,195	-	1,238	20
With an allowance recorded:					
Real estate - construction	$ 136	$ 136	$ 79	$ 137	$ 6
Real estate - commercial	69	69	3	71	3
Real estate - residential	335	335	40	343	13
Commercial and industrial	53	53	1	57	5
Consumer and other	36	36	1	38	3
	629	629	124	646	30
Total:					
Real estate - construction	$ 212	$ 212	$ 79	$ 216	$ 7
Real estate - commercial	398	398	3	406	8
Real estate - residential	971	1,359	40	997	22
Commercial and industrial	171	171	1	185	8
Consumer and other	72	72	1	80	5
	$ 1,824	$ 1,824	$ 124	$ 1,884	$ 50

Note 5. Loans Receivable, Continued

The following is an analysis of our nonaccrual loan portfolio recorded at December 31:

(Dollars in thousands)	2018	2017
Real estate - construction	$ 36	$ 211
Real estate - commercial	582	335
Real estate - residential	1,304	730
Commercial and industrial	144	118
Consumer and other	27	36
	$ 2,093	$ 1,430

Troubled Debt Restructurings

The following table summarizes the carrying balance of troubled debt restructurings (TDRs) as of December 31:

(Dollars in thousands)	2018	2017
Performing TDRs	$ 356	$ 330
Nonperforming TDRs	155	282
Total TDRs	$ 511	$ 612

Loans classified as TDRs may be removed from this status for disclosure purposes after a specified period of time if the subsequent restructured agreement specifies an interest rate equal to or greater than the rate that the lender was willing to accept at the time of the restructuring for a new loan with comparable risk, the loan is performing in accordance with the terms specified by the restructured agreement, and certain other criteria are met.

There were no loans determined to be TDRs during the year ended December 31, 2018. During the year ended December 31, 2018, no loans that had been restructured during the previous year subsequently defaulted during the year.

The following is an analysis of TDRs identified during 2017:

(Dollars in thousands, except number of contracts)	For the year ended December 31, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Real estate - construction	-	$ -	$ -
Real estate - commercial	1	138	138
Real estate - residential	-	-	-
Commercial and industrial	-	-	-
Consumer and other	-	-	-
Total	1	$ 138	$ 138

During the year ended December 31, 2017, we modified one loan that was considered to be troubled debt restructuring. We extended the term for this loan. During the year ended December 31, 2017, no loans that had been restructured during the previous year subsequently defaulted during the year.

Note 5. Loans Receivable, Continued

Acquired Loans:

On November 30, 2018, the Company acquired Heritage (see Note 2 for more information). PCI loans acquired totaled $0.8 million, and acquired performing loans totaled $78.4 million, both net of purchase discounts. The gross contractual amount receivable for PCI loans and acquired performing loans was approximately $1.2 million and $81.2 million, respectively, as of the acquisition date. The fair value of the total loan portfolio was estimated to be $79.8 million, which represents a $2.6 million discount.

The following table presents changes in the carrying value of PCI loans for the year ended December 31:

(Dollars in thousands)	**2018**
Balance at beginning of period	$ -
Additions due to acquisition of Heritage	832
Change due to payments received and accretion	-
Advances	-
Balance at end of period	$ 832

The following table presents changes in the nonaccretable yield for PCI loans for the year ended December 31:

(Dollars in thousands)	**2018**
Balance at beginning of period	$ -
Additions due to acquisition of Heritage	224
Reclassification to accretable yield	-
Change due to charge-offs	-
Balance at end of period	$ 224

The following table presents changes in the accretable yield for PCI loans for the year ended December 31:

(Dollars in thousands)	**2018**
Balance at beginning of period	$ -
Additions due to acquisition of Heritage	116
Reclassification from accretable yield	-
Accretion, net cash basis interest collections	-
Balance at end of period	$ 116

Note 6. Other Real Estate Owned

The following summarizes the activity in the other real estate owned for the years ended December 31:

(Dollars in thousands)	2018	2017
Balance, beginning of year	$ 197	$ 618
Additions	517	31
Sales	(165)	(403)
Writedowns	(26)	(49)
Balance, end of year	$ 523	$ 197

Note 7. Premises and Equipment

Premises and equipment is summarized as follows as of December 31:

(Dollars in thousands)	2018	2017
Land	$ 5,108	$ 4,581
Building and improvements	16,230	13,135
Furniture and equipment	5,711	4,839
Total	27,049	22,555
Less accumulated depreciation	(10,477)	(9,826)
Premises and equipment, net	$ 16,572	$ 12,729

Depreciation expense for the years ended December 31, 2018 and 2017 was $675,627 and $679,354, respectively.

Note 8. Goodwill and Core Deposit Intangible

The following table presents information about our core deposit intangible asset at December 31:

	2018		2017	
(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Finite lived intangible asset:				
Core deposit intangible	$ 2,049	$ -	$ 1,412	$ 1,378

Note 8. Goodwill and Core Deposit Intangible, Continued

Based on the core deposit intangibles as of December 31, 2018, the following table presents the aggregate amortization expense for each of the succeeding years ending December 31:

(Dollars in thousands)	Amount
2019	$ 205
2020	205
2021	205
2022	205
2023 and thereafter	1,229
Total	$ 2,049

Amortization expense of $34,357 and $125,617 related to the core deposit intangibles was recognized in 2018 and 2017, respectively.

As of December 31, 2018 and 2017, goodwill totaled $6,736,000 and $3,427,000, respectively. Goodwill is reviewed for impairment annually in accordance with generally accepted accounting principles. The Company's evaluation considers various components, to include economic conditions, industry considerations, financial performance as well as other information. As of December 31, 2018 and 2017, management determined that no impairment existed on the goodwill.

Note 9. Deposits

At December 31, 2018, the scheduled maturities of certificates of deposit are as follows:

(Dollars in thousands)	Amount
2019	$ 79,970
2020	24,346
2021	3,513
2022	2,913
2023 and thereafter	2,157
Total	$ 112,899

Time deposits that meet or exceed the FDIC Insurance limit of $250,000 at year end 2018 and 2017 were $15,296,290 and $7,708,344, respectively.

Overdrawn transaction accounts in the amount of $301,618 and $246,913 were classified as loans as of December 31, 2018 and 2017, respectively.

Note 10. Advances from Federal Home Loan Bank

Advances from the Federal Home Loan Bank (FHLB) consisted of the following at December 31, 2018 and 2017:

(Dollars in thousands)

Description	Current Interest Rate	2018 Balance	2017 Balance
Fixed rate advances maturing			
January 25, 2018	2.04%	$ -	$ 1,000
May 21, 2018	2.04%	-	1,000
May 21, 2018	2.04%	-	1,000
July 11, 2018	2.04%	-	2,000
August 15 2018	2.04%	-	2,000
January 23, 2019	2.04%	1,000	-
November 12, 2027	1.61%	4,000	4,000
November 12, 2027	1.41%	4,000	4,000
		$ 9,000	$ 15,000

Scheduled maturities of the advances are as follows:

(Dollars in thousands)	Amount
2019	$ 1,000
Thereafter	8,000
	$ 9,000

Each of the advances are subject to early termination options. The FHLB reserves the right to terminate each agreement at an earlier date.

As collateral, the Bank has pledged first mortgage loans on one to four family residential loans aggregating $72,532,984 at December 31, 2018. In addition, the Company's Federal Home Loan Bank stock is pledged to secure the borrowings. Certain advances are subject to prepayment penalties.

Note 11. Lease Commitments

The Bank has entered into agreements to lease its office facilities under non-cancelable operating lease agreements expiring on various dates through January 31, 2028. Minimum rental commitments under the leases are as follows:

(Dollars in thousands)	Amount
2019	$ 113,400
2020	113,400
2021	113,400
2022	111,450
2023 and thereafter	468,000
Total	$ 919,650

The Bank's rental expense for its office facilities for the years ended December 31, 2018 and 2017 totaled $173,370 and $82,165, respectively.

Note 12. Stock Options

The Company entered into a stock option agreement with two entities that are controlled by several major shareholders of the Company that provides for the purchase of shares of common stock at a price of $2.64 per share.

There were 79,602 options outstanding as of December 31, 2018 and 2017. As of December 31, 2018, all of the outstanding options were exercisable. None of the options outstanding at December 31, 2018 have an expiration date. The aggregate intrinsic value of these options was $2,177,911 and $2,038,607 at December 31, 2018 and 2017, respectively. During 2018 and 2017, no options were exercised.

Note 13. Earnings Per Share

Earnings per share - basic is computed by dividing net income by the weighted average number of common shares outstanding. Earnings per share - diluted is computed by dividing net income by the weighted average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding stock options. Unallocated common shares held by the employee retirement and stock ownership plan are excluded from the weighted average number of common shares outstanding.

(Dollars in thousands, except share and per share amounts)	2018	2017
Basic earnings per common share:		
Net income available to common shareholders	$ 4,249	$ 3,732
Basic average common shares outstanding	1,763,202	1,771,614
Basic earnings per common share	$ 2.41	$ 2.11
Diluted earnings per common share:		
Net income available to common shareholders	$ 4,249	$ 3,732
Basic average common shares outstanding	1,763,202	1,771,614
Incremental shares from assumed conversions:		
Stock options	72,387	71,634
Diluted average common shares outstanding	1,835,589	1,843,248
Diluted earnings per common share	$ 2.31	$ 2.02

Note 14. Capital Requirements and Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

Note 14. Capital Requirements and Regulatory Matters, Continued

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios (set forth in the table below) of Tier 1, Common Equity Tier 1 (CET1), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 150%. Tier 1 capital of the Bank consists of common stockholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Bank is also required to maintain capital at a minimum level based on average assets (as defined), which is known as the leverage ratio. Only the strongest institutions are allowed to maintain capital at the minimum requirement. All others are subject to maintaining ratios 1% to 2% above the minimum.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"), require the Bank to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will be required to consist solely of CET1, but the buffer will apply to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer will be phased in incrementally over time, beginning January 1, 2016 at 0.625% and becoming fully effective on January 1, 2019, and will ultimately consist of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets.

As of December 31, 2018, the most recent notifications from the Bank's primary regulator categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events that management believes have changed the Bank's categories.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements at December 31, 2018 and 2017:

(Dollars in thousands)	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2018						
The Bank						
Total capital (to risk weighted assets)	$ 53,565	14.51%	$ 29,542	8.00%	$ 36,927	10.00%
Tier 1 capital (to risk weighted assets)	50,248	13.61%	22,156	6.00%	29,542	8.00%
Tier 1 capital (to average assets)	50,248	10.83%	18,562	4.00%	23,202	5.00%
Common Equity Tier 1 Capital (to risk-weighted assets)	50,248	13.61%	16,617	4.50%	24,003	6.50%

Note 14. Capital Requirements and Regulatory Matters, Continued

(Dollars in thousands)	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2017						
The Bank						
Total capital (to risk weighted assets)	$ 46,333	17.14%	$ 21,627	8.00%	$ 27,033	10.00%
Tier 1 capital (to risk weighted assets)	42,953	15.89%	16,220	6.00%	21,627	8.00%
Tier 1 capital (to average assets)	42,953	9.97%	17,236	4.00%	21,545	5.00%
Common Equity Tier 1 Capital (to risk-weighted assets)	42,953	15.89%	12,165	4.50%	17,572	6.50%

Note 15. Restrictions on Dividends, Loans, and Advances

The ability of the Company to pay cash dividends to shareholders is dependent on its ability to receive cash, in the form of dividends from the Bank. South Carolina banking regulations restrict the amount of dividends that can be paid to shareholders. All of the Bank's dividends to the parent company are payable only from the retained earnings of the Bank. At December 31, 2018, the Bank's retained earnings were $41,196,045. The Bank is authorized to pay cash dividends up to 100% of net income in any calendar year without obtaining the prior approval of the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last Federal or State regulatory examination. Under Federal Reserve Board regulations, the amounts of loans or advances from the Bank to the parent company are also restricted.

Note 16. Employee Retirement and Stock Ownership Plan

The Company sponsors an employee retirement and stock ownership plan. Employees eligible for the Company stock component of the KSOP plan include all employees who work at least 1,000 hours during the initial twelve consecutive months of employment, or any plan year beginning after the date of employment. The Company periodically makes discretionary contributions to the KSOP. For the years ended December 31, 2018 and 2017, the Company contributed $147,373 and $130,797 to the KSOP, respectively.

Shares of the Company held by the KSOP are as follows at December 31:

	2018	2017
Allocated shares	84,683	84,228
Shares released for allocation	-	-
Unreleased shares	-	-
	84,683	84,228

Note 17. Income Taxes

The Tax Cuts and Jobs Act (TCJA) was signed into law by the President on December 22, 2017. The TCJA includes the reduction in the corporate tax rate from a top rate of 35% to a flat rate of 21% beginning in 2018, changes in business deductions, and many international provisions.

Income tax expense is summarized as follows for the years ended December 31:

(Dollars in thousands)	2018	2017
Current income tax expense:		
Federal	$ 1,117	$ 1,793
State	194	168
Total current	1,311	1,961
Deferred income tax expense	53	610
Income tax expense	$ 1,364	$ 2,571

The components of the net deferred tax asset were as follows as of December 31:

(Dollars in thousands)	2018	2017
Deferred tax assets:		
Other real estate owned	$ 87	$ 68
Allowance for loan losses	601	615
Interest on nonaccrual loans	50	32
Reserve for contingencies	45	27
Unrealized loss on securities available for sale	611	422
Market-to-market purchase accounting	117	60
Unearned income	6	3
Net operating losses	511	8
Other	-	2
Gross deferred tax assets	2,028	1,237
Valuation allowance	77	8
Net deferred tax assets	1,951	1,229
Deferred tax liabilities:		
Accumulated depreciation	245	268
Market-to-market purchase accounting	-	29
Goodwill	99	85
Other	244	-
Total deferred tax liabilities	588	382
Net deferred tax asset	$ 1,363	$ 847

Tax returns for 2015 and subsequent years are subject to examination by taxing authorities.

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. As of December 31, 2018 and 2017, management has recorded a valuation allowance of approximately $77,000 and $8,000, respectively. The valuation allowance is associated with South Carolina net operating losses at the Holding Company. Management determined that it is more likely than not that the remaining deferred tax asset at December 31, 2018 and 2017 will be realized and, accordingly, did not establish a valuation allowance on those assets.

Note 17. Income Taxes, Continued

The Company has federal net operating losses of $2,032,698 as of December 31, 2018, which have no expiration. The Company has state net operating losses of $2,138,681 for the year ended December 31, 2018. These state losses begin to expire in the year 2024. As a result of the Heritage ownership change in 2018, Section 382 of the Internal Revenue Code places an annual limitation on the amount of federal net operating loss carryforwards which the Company may utilize. The Company expects the remaining Section 382 limited carryforwards to be realized within the applicable carryforward period.

A reconciliation between the income tax expense and the amount computed by applying the Federal statutory rate of 21% and 34% respectively to income before income taxes follows for the years ended December 31:

(Dollars in thousands)	2018	2017
Tax expense at statutory rate	$ 1,179	$ 2,143
State income tax, net of federal income tax benefit	153	111
Tax-exempt interest income	(82)	(144)
Nondeductible interest expense to carry tax-exempt instruments	2	3
Change in valuation allowance	69	1
Tax impact of rate change	-	478
Other, net	43	(21)
Total	$ 1,364	$ 2,571

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with ASC Topic 740.

Note 18. Fair Value of Financial Instruments

Generally accepted accounting principles (GAAP) provide a framework for measuring and disclosing fair value that requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair value is defined as the exchange in price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of the lower of cost or market accounting or the writing down of individual assets.

Note 18. Fair Value of Financial Instruments, Continued

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These levels are:

Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available-for-Sale - Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans - The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represents loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2018 and 2017, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Note 18. Fair Value of Financial Instruments, Continued

Other Real Estate Owned - Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company recorded the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

	December 31, 2018			
(Dollars in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Government-sponsored enterprises	$ 41,577	$ -	$ 41,577	$ -
Obligations of state and local governments	18,538	-	18,538	-
U.S. Treasuries	9,796	-	9,796	-
Total	$ 69,911	$ -	$ 69,911	$ -

	December 31, 2017			
(Dollars in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Government-sponsored enterprises	$ 41,983	$ -	$ 41,983	$ -
Obligations of state and local governments	19,623	-	19,623	-
U.S. Treasuries	3,867	-	3,867	-
Total	$ 65,473	$ -	$ 65,473	$ -

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy described above for which a nonrecurring change in fair value has been recorded as of December 31, 2018 and 2017.

	December 31, 2018			
(Dollars in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Other real estate owned	$ 523	$ -	$ -	$ 523
Impaired loans, net specific reserve:				
Real estate - construction	36	-	-	36
Real estate - commercial	1,039	-	-	1,039
Real estate - residential	1,398	-	-	1,398
Commercial and industrial	137	-	-	137
Consumer and other	35	-	-	35
Total impaired loans, net specific reserve	2,645	-	-	2,645
Total	$ 3,168	$ -	$ -	$ 3,168

Note 18. Fair Value of Financial Instruments, Continued

	December 31, 2017			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Other real estate owned	$ 197	$ -	$ -	$ 197
Impaired loans, net specific reserve:				
Real estate - construction	133	-	-	133
Real estate - commercial	395	-	-	395
Real estate - residential	931	-	-	931
Commercial and industrial	170	-	-	170
Consumer and other	71	-	-	71
Total impaired loans, net specific reserve	1,700	-	-	1,700
Total	$ 1,897	$ -	$ -	$ 1,897

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2018 and December 31, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value as of December 31, 2018	Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Impaired loans, net of specific reserve	$ 2,645	Appraisal Value	Appraisals and/or sales of comparable properties	Appraisals discounted 15% for sales commissions and other holding cost
Other real estate owned	$ 523	Appraisal Value/Comparison Sales/Other estimates	Appraisals and/or sales of comparable properties	Appraisals discounted 15% for sales commissions and other holding cost

	Fair Value as of December 31, 2017	Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Impaired loans, net of specific reserve	$ 1,700	Appraisal Value	Appraisals and/or sales of comparable properties	Appraisals discounted 15% for sales commissions and other holding cost
Other real estate owned	$ 197	Appraisal Value/Comparison Sales/Other estimates	Appraisals and/or sales of comparable properties	Appraisals discounted 15% for sales commissions and other holding cost

Note 19. Commitments and Contingencies

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Management is not aware of any legal proceedings, which would have a material adverse effect on the financial position or operating results of the Company.

Note 20. Unused Lines of Credit

At December 31, 2018, the Company had unused lines of credit to purchase federal funds from other financial institutions totaling $15,000,000. Under the terms of the agreements, the Company may borrow at mutually agreed-upon rates for one to fifteen day periods. The Company also has a line of credit to borrow funds from the Federal Home Loan Bank which totaled $107,336,500 as of December 31, 2018. As of December 31, 2018, the Bank had borrowed $9,000,000 on this line.

Note 21. Financial Instruments With Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Note 21. Financial Instruments With Off-Balance Sheet Risk, Continued

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counter-party.

Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties. The following table summarizes the Company's off-balance-sheet financial instruments whose contract amounts represent credit risk as of December 31:

(Dollars in thousands)	2018	2017
Commitments to extend credit	$ 44,270	$ 32,684
Standby letters of credit	986	951

Note 21. Related Party Transactions

Certain parties (principally certain directors and shareholders of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Bank. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectability. The aggregate dollar amount of loans to related parties was $3,895,669 and $2,010,062 at December 31, 2018 and 2017, respectively.

Deposits by directors including their affiliates and executive officers totaled approximately $3,516,669 and $2,483,080 at December 31, 2018 and 2017, respectively.

Note 23. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through April 9, 2019, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Note 24. Citizens Bancshares Corporation (Parent Company Only)

Following is condensed financial information of Citizens Bancshares Corporation (parent company only) as of and for the years ended December 31:

Condensed Balance Sheets

(Dollars in thousands)	December 31, 2018	December 31, 2017
Assets		
Cash	$ 607	$ 26
Investment in banking subsidiary	54,465	45,089
Goodwill	2,899	-
Other assets	93	-
Total assets	$ 58,064	$ 45,115
Liabilities		
Junior subordinated debenture	$ 2,899	$ -
Shareholders' equity	$ 55,165	$ 45,115
Total liabilities and shareholders' equity	$ 58,064	$ 45,115

Condensed Statements of Income

	For the years ended December 31, 2018	For the years ended December 31, 2017
Income		
Dividends from banking subsidiary	$ 5,500	$ 1,500
Total income	5,500	1,500
Expenses		
Miscellaneous expenses	19	10
Interest expense	32	-
Total expenses	51	10
Income before income taxes and equity in undistributed earnings of banking subsidiary	5,449	1,490
Net equity in undistributed (loss) earnings of banking subsidiary	(1,200)	2,242
Net income	$ 4,249	$ 3,732

Note 24. Citizens Bancshares Corporation (Parent Company Only)

Condensed Statements of Cash Flows

	For the years ended December 31,	
	2018	**2017**
Operating activities		
Net income	$ 4,249	$ 3,732
Adjustments to reconcile net income to net cash provided by operating activities:		
Net equity in undistributed loss (earnings) of subsidiaries	1,200	(2,242)
Net cash disbursed in business combination	(4,345)	-
Net cash provided by operating activities	1,104	1,490
Cash flows from financing activities		
Cash dividends paid	(523)	(507)
Treasury stock purchased	-	(1,377)
Net cash used in financing activities	(523)	(1,884)
Net increase (decrease) in cash and cash equivalents	581	(394)
Cash, beginning of year	26	420
Cash, ending of year	$ 607	$ 26

The Citizens Bank Board of Directors

Robert W. Askins
General Contractor
RW Askins Construction, Inc.

Joseph L. Bostick, Jr.
Retired Oil Distributor

H. Blake Gibbons, Jr.
President & Chief Operating Officer

Samuel A. Rodgers, Jr.
Executive Vice President
Carolina Eastern, Inc.

Philip M. Smith
Retired Bank Officer

James H. Johnson
Vice President Merchandising
W. Lee Flowers, Inc.
KJ's Market

Michael L. Hodge, M.D.
Neurologist
McLeod Health

Kenneth W. Lee
Retired Bank Officer

C. Dorn Smith, III, M.D.
Chief Executive Officer & Chairman of the Board
Cardio Thoracic Surgeon
Williamsburg Regional Hospital

Gosnold G. Segars
President
G. Graham Segars & Sons, Inc.
Real Estate Brokerage

Citizens Bancshares Corporation Board of Directors

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General Contractor
RW Askins Construction, Inc.

Joseph L. Bostick, Jr.
Retired Oil Distributor

H. Blake Gibbons, Jr.
President & Chief Operating Officer

C. Dorn Smith, III, M.D.
Chief Executive Officer & Chairman of the Board
Cardio Thoracic Surgeon
Williamsburg Regional Hospital

Dawn M. Floyd
Pharmacist
CVS

James H. Johnson
Vice President Merchandising
W. Lee Flowers, Inc.
KJ's Market

Samuel A. Rodgers, Jr.
Executive Vice President
Carolina Eastern, Inc.

Michael L. Hodge, M.D.
Neurologist
McLeod Health

Dixie S. Bullock
Director

Andrew B. Smith
Director

Executive Officers

C. Dorn Smith, III, M.D.
Chief Executive Officer &
Chairman of the Board

H. Blake Gibbons, Jr.
President & Chief Operating Officer

William J. Heustess, Jr.
Executive Vice President &
Chief Credit Officer

R. Ashley Wheeler, Jr.
Executive Vice President &
Chief Financial Officer & Secretary

Thomas Bouchette
Executive Vice President &
Chief Banking Officer

Richard W. McCutcheon
Senior Vice President

James E. Roberts, II
Senior Vice President

Corporate Office

C. Dorn Smith, III	Chief Executive Officer
H. Blake Gibbons, Jr.	President
Thomas Bouchette	Executive Vice President
William J. Heustess, Jr.	Executive Vice President
R. Ashley Wheeler, Jr.	Executive Vice President
James E. Roberts, II	Senior Vice President
Sherry D. Coker	Vice President
Robert F. Dukes, Jr.	Vice President
Margi M. Fleming	Vice President
Glenn D. Buddin, Jr.	Vice President
Cheryl A. Matthews	Assistant Vice President
Heather R. Thomy	BSA Officer

Operations Center

Teresa L. Floyd	Vice President
Thomas D. Ham, II	Vice President
Rheba C. Welch	Vice President
Leah C. Hancock	Assistant Vice President
Elizabeth M. Atkinson	Assistant Vice President
Sherry P. Matthews	Assistant Vice President
Eric M. Pagan	Banking Officer

Olanta Branch

Randal E. Carter	Vice President

Turbeville Branch

Susan H. Alexander	Vice President

Lake City Branch

Richard W. McCutcheon	Senior Vice President
Robert S. Phillips, II	Assistant Vice President

Sumter Branch

Randy S. Brown	Senior Vice President
Samuel T. Dubose	Vice President
Paul E. Robbins	Vice President
Steven D. Cook	Assistant Vice President

Pawleys Island Branch

Joel W. Odom	Senior Vice President
Elliott S. Koonce	Vice President
Gregory A. Badgett	Assistant Vice President

Timmonsville Branch

Sharon L. Green	Vice President
Jan G. Vause	Banking Officer

St. George Branch

William M. Utsey, Jr.	Senior Vice President
Gregory P. Shuler	Assistant Vice President

"List as of December 31, 2018"

Florence-Pamplico Hwy Branch

Cherry T. Gerald	.....	Assistant Vice President
Gwendolyn A. Dutton	.....	Assistant Vice President
Shirley J. Greene	.....	Assistant Vice President

Florence-Palmetto Street Branch

John T. Hanna	.....	Senior Vice President
Adam V. Gamble	.....	Assistant Vice President
Robin A. Poston	.....	Banking Officer

Pamplico Branch

Pamela M. Turner	.....	Banking Officer

Johnsonville Branch

Ronald L. Coker, Jr.	.....	Assistant Vice President

Georgetown Branch

William D. Starnes	.....	Vice President
Teresa M. Harrelson	.....	Assistant Vice President

Kingstree Branch

Alan K. Chandler	.....	Vice President
Glenda Miller	.....	Banking Officer

Murrells Inlet Branch

Deborah A. Burroughs	.....	Vice President
Tanya L. Yow	.....	Assistant Vice President

Hartsville Branch

J. Darrell Cassidy	.....	Vice President
William M. Scarborough, Jr.	.....	Vice President
P. Ross Johnson	.....	Assistant Vice President
Denise L. Tedder	.....	Branch Manager

McBee Branch

Carmen D. Jackson	.....	Assistant Vice President
Lynda Weatherford	.....	Banking Officer

Camden Branch

Deborah P. Outlaw	.....	Vice President

"List as of December 31, 2018"

THE CITIZENS BANK

Annual Financial Disclosure Statement
furnished pursuant to Part 350 of the Federal Deposit
Insurance Corporation's rules and regulations

For the year ended December 31, 2018

**THIS STATEMENT HAS NOT BEEN REVIEWED,
OR CONFIRMED FOR ACCURACY OR RELEVANCE BY THE
FEDERAL DEPOSIT INSURANCE CORPORATION.**

Citizens
Bancshares
Corporation

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